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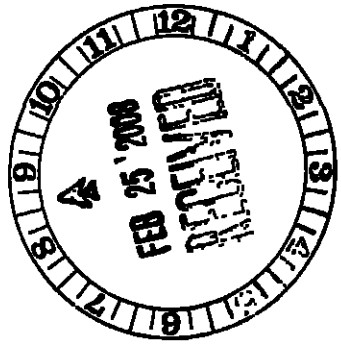

Hon. Anne K. Quinlan
Acting Secretary
Surface Transportation Board
395 E St., SW
Washington, D.C. 20024

Re: South Plains Switching Ltd. Co. - Compensation for Use of Facilities in Alternative Rail Service - West Texas & Lubbock Railway Company, F.D. 35111

filing of reply memorandum due 2/25

Dear Madam Secretary:

Enclosed for filing please find the original and ten copies of a Reply Memorandum, with an attached verification and exhibit, for filing on behalf of PYCO Industries, Inc., and West Texas & Lubbock Railway Company in the above-captioned proceeding. This Board's Decision served January 11, 2008, in this proceeding requires reply memoranda to be filed within 45 days of the decision date, which works out to February 25, 2008.

By my signature below, I certify service of a copy of the foregoing upon counsel for the petitioning party (South Plains Switching), Thomas McFarland, Esq., 208 South LaSalle St., Suite 1890, Chicago, IL 60604-1112 by deposit on the date of this letter for express (next business day) delivery.

Thank you for your assistance in this matter.

Very truly,

Charles H. Montange
for PYCO Industries, Inc.

Encls.

cc. Mr. McFarland (SAW) (w/encls)
Mr. Heffner (WTL) (w/encls)
Mr. McLaren (PYCO) (w/encls)

BEFORE THE SURFACE TRANSPORTATION BOARD

South Plains Switching Ltd. -)
Compensation for Use of)
Facilities in Alternative) F.D. 35111
Rail Service - West Texas &)
Lubbock Railway Co.)

Reply Memorandum
for West Texas & Lubbock Railway Co.
and
PYCO Industries, Inc.

This Reply Memorandum on behalf of West Texas & Lubbock Railway Company (WTL) and PYCO Industries, Inc. (PYCO) is in response to the opening memorandum e-filed by South Plains Switching Ltd. (SAW) on February 11.

I. SAW's Pleading Is Unresponsive

In its January 11, 2008, Decision in this proceeding, slip op. at 6-7, this Board indicated that it viewed Dardanelle & Russellville Railroad - Trackage Rights Compensation - Arkansas Midland Railroad Company, F.D. 32625, served June 3, 1996, as setting forth the governing formula for compensation for use of facilities of an incumbent railroad during alternative service. The formula has three parts: (1) variable costs to the incumbent resulting from the alternative service carrier's operations over the incumbent's lines, (2) the proportionate share of maintenance and repair expenses, and (3) an interest or rental component designed to compensate the incumbent for the alternative carrier's use of its lines. The Board further indicated that this latter component would be based on the NLV approach which

the Board had also used in the related feeder line case (F.D. 34890).

SAW's February 11 filing was not responsive to this Board's January 11 decision. SAW instead states that the Dardanelle case, and its formula, are not controlling. SAW "Statement" Tab 2, p. 3. As an apparent consequence, SAW did not provide evidence or argument based on variable costs or maintenance. Moreover, SAW implicitly disavowed the NLV approach to compensation indicated by the Board. SAW's failure to provide evidence or argument responsive to Dardanelle after this Board's January 11 decision amounts to a waiver of any right to compensation. For this reason alone, SAW should take nothing in this proceeding.

Without waiver of the foregoing position, PYCO and WTL accept the Dardanelle formula as applicable, with one caveat: SAW incurred no variable (or avoidable) costs, nor did it incur, and it certainly does not rely upon, any maintenance expenditures either.[1] Thus, the only Dardanelle factor for which

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[1] As PYCO and WTL indicated in our Opening Memorandum (p. 6 n.6), SAW in discovery disavowed any variable costs, or for that matter any maintenance, other than a claim to have done some on Track 9298. But as to that maintenance, SAW indicated it would not place any reliance for purposes of its claim to compensation. Since SAW disavows variable costs and maintenance anywhere but on Track 9298, as to which it states it will not rely, this Board should and must not award any compensation for variable costs or maintenance. In any event, PYCO and WTL have shown that SAW incurred no such costs by reason of alternative service.

reimbursement may be calculated is a reasonable return on the value of the SAW assets used for service to PYCO during the alternative use period.

This is not a claim that the Dardanelle formula is inapplicable generally, but rather acknowledgment of how it applies when an incumbent railroad provides no services, does not perform maintenance, and incurs no variable costs, as was the case here.[2]

In terms of the "rental component," the Dardanelle formula as construed by the Board is consistent with several long-established principles pertinent here, which are succinctly summarized in the Board's regulations dealing with OFA's: "Fair market value equals constitutional minimum value which is the greater of the net liquidation value of the line or the going concern value of the line."[3] And, in the case of "rental"-type situations (so-called "subsidy OFA's"), the value is "a reasonable return on the value of the line" in the absence, as here, of any "avoidable cost of providing continued rail

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[2] AS SAW notes in its "Statement" 3, this Board in adopting Parts 1146 and 1147 providing for alternative service, indicated that it would not prescribe an "abstract ... compensation formula" but would be "guided by established precedent, taking into account the circumstances of the particular case."

[3] 49 C.F.R. 1152.27(h)(6).

service."[4]

In SAW's "Statement," SAW did not present any evidence on the NLV approach which this Board indicated it intended to apply to determine compensation for the "interest" or "rental" component. However, in response to PYCO's discovery requests, SAW essentially conceded that the trackage PYCO used for its estimates of the "interest" or "rental" component was correct.[5] In discovery, SAW also conceded the unit values used by PYCO to calculate NLV.[6] All those values comport with what this Board found in its Decision served August 31, 2007, in F.D. 34890. In effect, SAW has conceded that NLV for the assets involved in this proceeding may be based on the trackage PYCO and WTL have used all along and the unit values used by the Board.

It follows that if this Board determines that compensation is required, that compensation must be based on a reasonable return ("interest" or "rental"), based on the NLV's calculated by PYCO and WTL in their Opening Memorandum, reduced by set-off's for the additional costs incurred by WTL and PYCO due to SAW's admitted failure to maintain its trackage and for the costs

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[4] Id. 1152.27(h)(5). Reasonable return in the context of abandonment and subsidy OFA's is defined in terms of a railroad's cost of capital. 49 C.F.R. 1152.34(d).
In a subsidy OFA, if the incumbent railroad in fact incurs an avoidable cost, that is reimbursed.

[5] WTL/PYCO Opening Memo at 7-8.

[6] Id. 8.

incurred by WTL in pulling cars for SAW from the BNSF yard to the SAW yard. These set-off's total at least $97,610.36.[7]

This Board annually measures the railroad "cost of capital" and this figure is used for virtually all rail regulatory purposes including abandonment, feeder line, and trackage right proceedings. See Use of a Multi-State Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital, STB Ex Parte 664 (Sub-no. 1), Decision served Feb. 11, 2008, slip at 1. See also Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital, STB Ex Parte 664, Decision served Jan. 17, 2008, slip at 1 & 3. The "cost of capital" as calculated by the Board is a proxy for "reasonable return" in such proceedings. This Board has recently indicated that it will revise its methodology to calculate "cost of capital" because past methodology has overstated the equity component. See

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[7] The set off's include the cost to WTL to pull 3834 SAW cars from the BNSF yard to the SAW yard for the benefit of SAW (WTL/PYCO Opening Memo p. 9 n.10 and sources cited), and $97,610.36 for re-railments, track repairs and other costs incurred by WTL or PYCO due to SAW's failure to maintain its tracks. WTL/PYCO Opening Memo at 9; Reply to SAW Petition at 10 & 19. PYCO and WTL repeatedly requested authority to enter upon SAW property to perform maintenance, but this Board denied such authority on the ground that the duty to maintain rested on SAW. E.g., Decision in F.D. 34802, served June 21, 2006, at 8. See also Decision in F.D. 34889, served Nov. 21, 2006, at 4-5 (noting SAW has not refuted WTL and PYCO claims of lack of maintenance) & 6. *SAW must bear the consequences of failing to discharge its* duty, rather than profit from ignoring this Board and inflicting costs upon WTL and PYCO. Any other result would be unjust enrichment of SAW.

Decision in Ex Parte 664, supra, at 1-2. As applied here, this indicates that use of the "cost of capital" (as WTL and PYCO have done here) likely overstates reasonable return for SAW.

As shown in the WTL/PYCO opening memorandum, reasonable return to SAW based on the "cost of capital" as calculated by this Board (i.e., using methodology which the Board now views as resulting in an overestimate for such cost) for the whole alternative service period amounts to no more than $45,116.22. Once set-off's (uncontested in SAW's pleadings to date) are taken into account, SAW is entitled to no additional compensation. In short, SAW has already received more than the constitutional minimum in compensation in the form of services performed by WTL for it, or in the form of costs SAW has unjustly visited upon WTL and PYCO during the alternative service period.

II. SAW's Alternative Case

SAW requests this Board to abandon the Dardanelle approach. But the Dardanelle approach as applicable here comports with the Board's precedent in similar (e.g., OFA,[8] feeder line,[9] and

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[8] 49 U.S.C. 10904 (OFA's) authorizes either acquisition or subsidization for one year of continued operation. For all practical purposes, acquisition price is based on NLV. Chicago & N.W. Transp. Co v. United States, 678 F.2d 665 (7th Cir. 1982). Subsidy for continued operation is based on "avoidable costs" plus the railroad cost of capital times the NLV. 49 C.F.R. 1152.27(h)(5).

[9] The feeder line standard for acquisition is the greater of NLV or GCV. See Decision, F.D. 34890, served August 31, 2007.

crossing[10]) proceedings. Moreover, this Board in adopting Parts 1146 and 1147 (providing for alternative service) clearly indicated that it would follow two principles in the context of computing compensation for incumbent railroads subject to alternative service orders: (1) appropriate application of precedent, and (2) refusal to award "profit."[11]

It would be arbitrary and capricious to deviate from these two principles at this time absent some compelling basis. SAW gives no real basis, let alone a compelling one.

A. SAW Offers No Basis to Deviate from Precedent

One argument SAW seems to advance for deviating from precedent is that SAW claims it is entitled to fair market value. SAW Statement, Tab 2. But SAW achieves this under Dardanelle. "Fair market value" is generally taken to mean the price that a willing buyer would pay, and willing seller would accept, for a property in an arms-length transaction with the parties acting knowledgeably, prudently and voluntarily (without compulsion).[12]

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[10] Crossing compensation under 49 U.S.C. 10901(d) is based on NLV, not foregone revenue, let alone possible future foregone revenue, of the carrier crossed. Chicago & N.W.-Construction and Operation Exemption - City of Superior, F.D. 32433 (sub-no.1), ICC served August 11, 1995.

[11] Expedited Relief for Service Inadequacies, Ex Parte 628, served Dec. 21, 1998, slip p. 14.

[12] See, e.g., International Valuation Standards (IVS) 1, Market Value Basis of Valuation, 7th Ed.; The Appraisal of Real Estate, 12th Ed. (The Appraisal Institute).

There is voluminous STB precedent holding that fair market value in the context of rail assets subject to a common carrier obligation (as is the case here) is based on either "net liquidation value" (NLV), or, if greater, "going concern value" (GCV), and not on some hypothetical gross revenue stream.[13] In general, where, as here, GCV is less than NLV (as found by this Board in its August 31, 2007 decision in F.D. 34890), an annual "interest" or "rental" is based on the NLV multiplied by the railroad cost of capital. This Board calculates NLV on the basis of net salvage value of the rail assets plus the appraised value of fee-owned real estate interests.[14]

SAW also seems to suggest that SAW is somehow viscerally entitled to a monopoly profit. SAW's witness, Mr. Olmstead, complains that the $2.90/carload WTL and PYCO offered at the inception of alternative service in 2006 is slightly below 2 per cent of the revenue per car ($146.64) received by WTL in 2007. Olmstead at 5. SAW implies this is unreasonably low.

On the one hand, SAW and its witness misrepresent the situation. Based on more complete information than was available

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[13] For example, in Chicago & N.W., supra, ICC F.D. 32433 (Sub-no. 1), ICC equated "fair market value" to NLV, noting that this comported with the minimum value guaranteed by the Constitution, citing Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 4419 (1982).

[14] See, e.g., 49 C.F.R. 1152.34(c)(1)(iii): NLV for rail properties is "current appraised market value" for non-rail purposes.

in March of 2006, WTL and PYCO have adjusted the effective per car rate. In calculating $2.90/carload in March of 2006, PYCO and WTL employed proper methodology, but necessarily relied on estimated NLV of the alternative service assets (they were not permitted to inspect same for valuation purposes yet), and on estimated PYCO rail shipments for 2006. More precise estimates of NLV are now possible given the valuation proceedings in F.D. 34890. The revised "interest" on NLV for the alternative service trackage works out to a total of $44,116.22 for the entire alternative service period, before set-off's.[15] Since alternative service is over, PYCO and WTL have not divided this "rental" by number of cars to derive a per car equivalent, and continue to regard such an exercise as unnecessary in the circumstances here.[16] Dividing this figure by 6899 (the total

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[15] As to number of shipments, as indicated in the feeder line proceeding, agricultural (including cotton industry) traffic in Lubbock is volatile, and dependent on weather from the prior growing season. Shipments in 2007 were less than half of 2006 levels, as SAW well knows. As a result, PYCO and WTL necessarily adjust both the numerator and denominator to give a more accurate per car figure. The broader point, however, is that a per car figure is irrelevant since alternative service is over. All that is required is a straightforward calculation of "interest" or "rental" (railroad cost of capital) on the NLV of the SAW assets. (SAW incurred no variable costs, and in its discovery responses indicates it claims none.)

[16] As we have already noted, since SAW incurred or relies upon no variable costs, the number of cars handled by WTL over the lines in question is irrelevant to determination of a rental rate for them.

number of cars) results in $6.39/car, before set-off's. This amount provides an annual return in excess of 10% (in accordance with the Board's relevant determinations of railroad "cost of capital") on assets used for alternative service. That level of return is derived in full accordance with Board precedent for calculating fair and reasonable compensation, and as already noted, this Board has recently acknowledged that its methodology overstates "cost of capital."

On the other hand, the amount demanded by SAW in its "Statement" amounts to a whopping $208.90 ($75/car plus a per car fee equivalent of $133.92 [the amount resulting when $923,940 (SAW's storage demand) is divided by 6899 (total PYCO cars)]. $208.90 amounts to 142% of the maximum revenue per car SAW acknowledges was received by WTL. This is a demand for monopoly profits.

Since SAW demands more than WTL received, SAW would have WTL donate its services to the shipping public, even though those services were to remediate SAW's inadequate service to PYCO. This is a bit like requiring a bank to reimburse a bank robber for his losses when caught, plus what he would lose if he had instead engaged in gainful employment. SAW's demand is not just a demand for an unreasonable monopoly profit, but for a huge windfall.

Another way to approach the issue raised by Olmstead is to

determine the rate of return he and SAW seek based on the NLV of the assets in question. This is done by comparing their compensation demand to the value of all of SAW and to the value of the portion of SAW used for alternative service. (Since all parties appear to accept the NLV valuation and per unit valuations set forth in the August 31, 2007 feeder line proceeding, the value of all-SAW and value of the alternative service portion is not in serious dispute.) The total compensation demanded by Olmstead and SAW per the SAW "Statement" is $1,441,365. This amount is for use of a small portion of SAW's system (less than 10% by value) for alternative service from January 25, 2006 until November 9, 2007 (under 22 months).

The value of the entire SAW system, as found by STB in the feeder line proceeding per its August 31, 2007 decision, is $2,350,918. The actual assets of SAW used for alternative service carry a value of only $221,157.94 (under 10% of SAW's total system). WTL/PYCO Opening Memorandum at 9.

Per SAW and Olmstead, the rate of return demanded by SAW for 22 months of alternative service use by WTL is $1,441,365 divided by $2,340,918, or 61.6%. This works out to over 30% per year for the entire asset base of SAW. This is about three times the actual railroad cost of capital. But the situation is far worse, for the proper comparison is to the portion of assets actually used for alternative service. The rate of return SAW seeks there

is $1,441,365 divided by $221,157.94, or 651.7% for 22 months. This works out to over 325% per year. The maximum railroad cost of capital as determined by this Board was not greater than 12.2% for any portion of the 22 months at issue. Thus SAW seeks over 26 times (325% divided by 12.2%) the railroad cost of capital annually.

If the SAW/Olmstead views on valuation were correct, all railroads should provide inadequate rail service so they too can demand 300% annual rates of return on their assets when desperate shippers successfully seek relief from this Board. But this Board said that incumbent railroads are not to receive profit by reason of alternative service, let alone enormous windfalls. SAW's argument about levels of remuneration thus hardly justifies a departure from the Dardanelles approach; rather, it suggests a need to adhere to it and comparable precedent. This result is supported by federal rail policy as set forth in provisions like 49 U.S.C. 10101(4) (ensure development and continuation of a "sound rail transportation system"), 10101(5) (foster "sound economic conditions"), and 10101(12) (prohibits predatory pricing and practices).

B. In any Event, SAW's Opinion Evidence is Unreliable and Must Be Stricken or Given No Weight

In support of its contrarian approach, SAW relies exclusively on opinions as to the amount of compensation due SAW expressed by Mr. Dennis Olmstead. Mr. Olmstead is not an

employee of SAW, but a "consultant." His "evidence" is not directly observed, but based on what he has been told, and is thus hearsay. Under the Federal Rules of Evidence (to which this Board is to look on evidentiary matters pursuant to 49 C.F.R. 1114.1), hearsay is inadmissible. See F.R. Ev. 802. Moreover, Mr. Olmstead is simply a lay witness. Since he is not an employee of SAW, he does not have first hand knowledge or observation, and a lay witness cannot offer opinion except on that (non-hearsay) basis. F.R. Ev. 701 (and Advisory Committee notes thereto). In short, if Mr. Olmstead's hearsay opinions are admissible at all, they are admissible only if Mr. Olmstead is an expert and offers qualified expert testimony. He is neither an expert, at least in any area germane here, and his testimony does not qualify as expert testimony. Even if his opinions are presented not in court but instead to this agency, no weight should be placed upon them.

1. Mr. Olmstead's Hearsay Is Foreclosed by Daubert. F.R. Ev. 702 governs the conditions under which a trier of fact may consider expert testimony and opinion. Rule 702 permits expert opinion evidence based on "scientific, technical, or specialized skills" if the witness is "qualified as an expert by knowledge, skill, experience, training or education." In Daubert v. Merrell Dow Pharmaceutical's Inc., 509 U.S. 579, 113 S.Ct. 2786, 2795 (1993), the Supreme Court ruled that F.R.Ev. 702 (in conjunction

with F.R.Ev. 104(a)) requires that expert testimony, before being considered by a trier of fact, must be reliable and relevant. To be so, it must be grounded in the methods and procedures of science, and not simply a clever packaging of subjective beliefs and speculation. 113 S.Ct. at 2794. In Kumho Tire Co. v. Carmichael, 526 U.S. 136, 119 S.Ct. 1167, 1174, 1177-79 (1999), the Supreme Court extended this to apply to "non-scientific" expert testimony. The Court affirmed a district court's exclusion of a plaintiff's "expert" testimony because there was no proof that other experts in the field used the alleged expert's methodology and the alleged expert's methodology was not sufficiently reliable. Daubert applies to proffers of economics testimony. E.g., Virginia Vermiculite Ltd. v. W.R. Grace, 98 F.Supp.2d 729 (W.D. Va. 2000). It is clearly germane here.[17]

Although the case law is limited, the federal courts of appeals so far have endorsed the Daubert case as guidance for administrative agencies, because "'[j]unk science' has no more place in administrative proceedings than in judicial ones." Niam v. Ashcroft, 354 F.3d 652, 660 (7th Cir. 2004). See also Peabody

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[17] It is noteworthy that SAW did not rely on Olmstead for economic or appraisal analysis of the value of its system in the feeder line proceeding. SAW instead relied on other witnesses for those purposes. See SAW's Statement in Response to PYCO's Feeder Line Application to Acquire All SAW, filed Sept. 18, 2006 in F.D. 34890. Olmstead in tab 4 of that pleading was presented as a kind of traffic counter. Olmstead and SAW are going way beyond that scope here.

Coal Co. v. McCandless, 255 F.3d 464, 469 (7th Cir. 2001); Lobster Inc. v. Evans, 346 F.Supp.2d 340, 345 (D. Mass. 2004). Daubert in administrative proceedings is generally applied by ignoring or giving no weight to opinion evidence presented by non-experts on matters supposedly requiring specialized knowledge.

Mr. Olmstead's description of his background does not claim for him any training or education as an economist or real estate appraiser, nor does it demonstrate that he accumulated those skills in the course of his employment. Mr. Olmstead's "resume," such as it is, shows no peer-reviewed publications in either economics or appraisal theory. It nowhere discloses that he has ever appraised any particular asset, let alone a rail asset. On the basis of his own representations, he accordingly lacks any qualification to offer a reliable opinion on valuation. Accord Second Banks Declaration para 2.[5]

His "evidence" does not conform to any standards for an appraisal. In particular, his methodology does not follow any of the Uniform Standards of Professional Appraisal Practice (USPAP) established by the Appraisal Foundation, or rules under them. Indeed, his valuation does not even begin to comply with the form of an appraisal. For instance, although required by USPAP

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[5] Mr. Olmstead did not purport to offer opinions on valuation of SAW in the feeder line proceeding (F.D. 34890). SAW relied upon other witnesses for that purpose.

standards to define market value, Mr. Olmstead does not follow the usual definition set forth above, but instead suggests that property value, like the price of coffee at a coffee shop, can be ascertained essentially by looking at the menu of the local restaurants. This itself is wrong: the issue is the value of use of the restaurant facility (either as going concern or in liquidation), and that cannot be judged by looking at the price of one of its products.[19] In any event, Mr. Olmstead's reliance on $75/carload amounts to looking at one restaurant (SAW's track at Burris). He not only ignores everything else (like PYCO's $1/lease for some of the very trackage in question) but also the fact that the $75/carload he relies was the result of litigation (and thus not willing seller, willing buyer).[20] His views as to the $75 price point are thus not accepted economics or real estate appraisal methodology, and amount to pure speculation. Olmstead's hypothesis about storage track is even worse: this appears to be some kind of "going concern" or "income" valuation, but the numbers are purely hypothetical: the trackage has never been so "leased out." An income valuation is based on actual income, and projections therefrom. Moreover, it must take into account costs, which Olmstead fails to do. See Second Banks

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[19] See Second Banks Dec., Exhibit hereto, para. 4.

[20] Accord, Second Banks Declaration, para 5. See also Kring Verification to WTL/PYCO Opening Memo at para 2 ($1/yr lease).

Declaration para 9.

As to economic methodology, Mr. Olmstead clearly does not follow the Dardanelle methodology: he does not calculate variable costs (there were none anyway)[21], and he nowhere discusses NLV, GCV, or railroad cost of capital. His opinion is not based on any economic methodology that has ever been accepted at STB.

Since Mr. Olmstead has no credentials and follows no accepted methodology, his opinion on value is unreliable and would not be admissible under the Federal Rules of Evidence. This Board should accord it no weight.

2. Other Departures by Olmstead. The three most common means of appraising real property ("the appraisal trinity"[22]) are (1) the market or comparative sales approach (determine value based on comparable transactions involving similar properties in the vicinity), (2) the cost approach (replacement value, often taking into account depreciation) and (3) the income approach (capitalize the stream of revenue less costs). Olmstead uses

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[21] Olmstead does hypothesize a "cost" based on an "operating ratio" of another railroad which he says is similar to SAW. However, in discovery, SAW was requested to provide, but failed to provide, any basis for these assertions, and they must be discounted as pure speculation and hearsay entitled to no weight. In any event, SAW admitted no variable costs in discovery, other than some maintenance on Track 9298, which it said it would not rely upon. PYCO and WTL have submitted evidence that SAW did not maintain any of the trackage, and if SAW did anything, it was insignificant.

[22] Black's Law Dictionary 97 (7th ed. 1999).

none of these.

If anything, Olmstead appears to be trying to import an income stream unique to SAW's Burris property to the property used to meet PYCO's common carrier needs. But that does not comport with any approach: comparative sales, income, or cost. An income stream at Burris not only is not a comparable means to value a different asset (tracks used by WTL to serve PYCO), but also it must be adjusted for costs.

Olmstead also throws in irrelevancies. For example, he makes an assertion about SAW's costs per car based on the costs another railroad claims to incur as a proportion to its revenues. Olmstead at pp. 3-4. From this, he suggests that $75 is less than SAW's costs per car. However, SAW in its discovery responses admitted that it did not incur variable costs from alternative service. Thus Olmstead's reference to costs is contradicted by SAW itself, or else is a reference to what SAW would have incurred had it continued to serve PYCO. But it did not continue to serve PYCO. It is not entitled to costs it did not incur.[23] Since SAW incurred no variable costs by reason of WTL service, the entire $75/car figure amounts to an

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[23] PYCO requested all documents on which SAW's "experts" relied and SAW responded that all such documents were in SAW's original "petition." See WTL and PYCO Opening Memorandum, Attachment II, SAW response to PYCO discovery, p. 7, number 7. That "petition" contains nothing to support Olmstead's assertions about SAW's costs. They are rampant speculation.

unsubstantiated demand by Olmstead/SAW not just for SAW's lost profit, but for a windfall in terms of a revenue stream from which costs have not been deducted.[24]

Mr. Olmstead then goes on to calculate an additional $923,940 for alleged lost revenues for storing cars. As Mr. Banks points out in paragraph 9 of his Second Declaration attached hereto, Mr. Olmstead makes a whole series of implicit and erroneous assumptions for this analysis: he assumes all trackage actually available to WTL under the protocol to serve PYCO's Plant No. 2 could have been devoted to storage of rail cars on a permanent (24 hours per day, seven days per week, 365 days per year, or 24/7/365) basis; he assumes that there was a demand for such storage; he assumes that if there were such a demand, SAW could not meet that demand on the 90% of its system that it still "controlled"; he assumes that service to PYCO Plant 2 could be abandoned, so that the trackage could be used for permanent storage; and finally he assumes that SAW could do the storage without incurring any costs.

Olmstead's opinion in connection with the storage revenue theory likewise does not comport with any known methodology. This is not an income, replacement value, or comparative sales approach known to appraisers, or to economists. Since there is

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[24] That is a key point made by Mr. Banks in his Declaration attached as Appendix VII to the WTL/PYCO "Opening Memorandum."

no showing either of demand for storage, or that SAW lacked capacity to meet it elsewhere, the whole analysis is defective. It is likewise doomed by failure to consider costs. Olmstead projects a revenue of $100 in switch fees and $26.26/car in storage fees for his $923,940 storage valuation. Olmstead at 6-7.[25] But he ignores what he suggests are SAW's costs to provide service. Earlier in his hearsay opinion (Olmstead at 4), Olmstead estimates SAW's "costs" based on an "operating ratio" of another railroad (i.e., SAW's costs when operating) to be about $116 per car. He compares that to a notation he says he once saw (i.e., hearsay of recollected hearsay) saying BNSF's operating costs are $136/car to switch cars. Olmstead at 4.[26] But if SAW's costs to switch are somewhere between $116 and $136 per car, and SAW's revenue is only $126.25, it is not clear that SAW would make anything from storage even if it there was demand to fill up all the SAW tracks with storage cars. PYCO notes that SAW did not purport to include income streams from storage, let alone such storage as Olmstead hypothesizes, in its valuation for itself which it filed in F.D. 34890. This should raise implicit

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[25] PYCO never paid such switch fees to SAW (or to WTL), let alone on the track in question. WTL never collected such fees. The whole revenue stream is a creature of Mr. Olmstead's imagination.

[26] PYCO's discovery asked for all documents relied upon or reviewed by SAW's witnesses, including purported experts. PYCO was told there were none. This casts in further doubt the hearsay opinions of Olmstead.

alarm bells when Olmstead purports to project such revenues now. In any event, SAW furnishes no data indicating that alternative service resulted in any lost storage revenue, or that it lacked trackage on which to store cars and recognize such revenue, if it existed, which it did not. See note 25.

In addition, there is no showing that SAW (or subsequent to SAW, PYCO) ever charged the $100 per car to move cars for storage on which SAW relies. PYCO denies ever being charged, or ever paying, or ever charging another such fees. SAW's only showing is that amount is, according to SAW, in PYCO's own tariff. The referenced tariff is a mere adoption (in restated form) of SAW's tariff (which PYCO felt obligated to do pursuant to 49 U.S.C. 11101(c) when PYCO acquired all of SAW effective November 10, 2007). Both PYCO and WTL informed SAW in response to SAW's discovery that PYCO had not charged the amount to anyone since acquiring SAW. PYCO is unaware of any instance in which SAW charged the amount: SAW never levied this charge on PYCO (SAW did charge a "constructive placement" fee purportedly under another tariff as a means of retaliation against PYCO in late 2005), or so far as PYCO and WTL are aware, on any other customer.

3. Other problems with SAW's approach. SAW cannot claim that WTL was unjustly enriched: WTL did not store any cars on the SAW system. WTL used the trackage in question to serve

PYCO.[21] Neither WTL nor PYCO received any of the storage revenue SAW imputes.

In the alternative service proceedings, this Board authorized WTL to provide common carrier service to PYCO, not to use SAW tracks for third party storage activities as SAW posits. Thus Olmstead and SAW are proposing a compensation theory beyond the scope of the service authorization. WTL used the trackage to move cars to and from PYCO, and to stage cars for such movement; WTL had to keep the tracks clear of storage cars because all other routes (such as the most direct route, track 310) were in use by SAW to serve Compress and were congested with Compress traffic. In short, SAW wrongly seeks compensation for an illegal and unauthorized use of its tracks in which WTL did not engage.

4. Physical inconsistency. This raises another point: Olmstead's two valuation theories of $75/car for alternative service and $923,940 for foregone storage revenue are inherently inconsistent, or amount to double counting. SAW cannot use track for common carrier delivery of cars while at the same time congesting the same track with permanent storage. To do so would violate the laws of physics: no two pieces of matter, including

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[21] Track 9298 had traditionally been used by BNSF and SAW to stage cars for PYCO Plant No. 2, and the remaining trackage was a means to move cars to Plant No. 2. PYCO also leased Track 9298 for $1/year, quite different from the rate Olmstead implies with his $923,940 figure. Evidently Mr. Olmstead was oblivious to actual conditions and favored imaginary ones.

large pieces like railroad cars, can occupy the same space.[28] If SAW were to fill the alternative service tracks with stored cars as Olmstead predicates for his $923,940 storage theory of recovery, then no one could provide common carrier services over those tracks, on which Olmstead predicates his $75/car "rental" fee theory.[29] Olmstead and SAW need to elect one or the other of their faulty theories, for it is physically impossible to maintain both. Since there was a common carrier obligation to serve PYCO throughout the proceeding, presumably the Olmstead/SAW theory based on permanent congestion must be disregarded in total.

5. Summary. Neither of Olmstead's mutually inconsistent "rental" theories is based on net liquidation values and the applicable railroad cost of capital. Neither comports with real estate appraisal or economic valuation methodologies. Neither

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[28] STB should not award relief that is predicated on events inconsistent with physical reality. The fundamental law of nature applicable here flows from the Pauli exclusion principle: all matter is composed of electrons, protons and neutrons (collectively called fermions), and all these particles exhibit space-occupying behavior. Translated here, this means that if SAW (or anyone else) were to occupy the alternative service trackage with permanently stored cars as suggested by Olmstead, neither SAW nor anyone else could occupy that same space with trains pulling cars to or from PYCO. Any attempt to do so would result in a train wreck.

[29] The most direct way to serve PYCO was via Track 310, but that Track goes through Compress and is used to serve other shippers. SAW congested Track 310 such that WTL was able to use it only twice, as PYCO and WTL discussed in our opening memorandum.

results in a "fair" rental or interest rate. Neither is consistent with Dardanelle or any other applicable precedent. Neither is reliable. As between them, they are mutually inconsistent, not additive. Olmstead's opinions about them must be excluded or ignored under Daubert. As confirmed in Mr. Banks' Second Declaration, Mr. Olmstead's opinions are contrary to appraisal methodology, economic science, and, as indicated above, the laws of physics. Moreover, any "facts" he presents are unreliable hearsay, unsupported by anything in the record or produced in discovery.

III. Laches and Failure to Negotiate

SAW's position has been unreasonable from its inception. SAW demanded $75/carload from WTL in early 2006. WTL and PYCO responded that WTL was obligated only to cover costs SAW incurred and compensate SAW for the use of its physical plant based on NLV of the plant used. (The WTL/PYCO suggestion all along has been consistent with Dardanelle.) WTL and PYCO tendered an estimate of $2.90/carload based on that approach. SAW refused to negotiate. SAW remains stuck in its rut even after this Board in its January 11 decision instructed all parties to submit evidence consistent with Dardanelle. Notwithstanding this Board's direction concerning the proper means to calculate compensation, SAW continues to demand an arbitrary $75/carload. SAW now couples that arbitrary sum with a belated demand for an

additional $133.92 ($923,940 divided by 6899 cars) per car on an imaginary foregone storage revenue theory that, as we indicated, not only violates economic and appraisal realities, but also violates what is physically possible.

This Board's applicable regulations, and the applicable statutes, envision that the incumbent railroad will negotiate with the alternative rail carrier concerning compensation. SAW has unreasonably refused negotiation; SAW underscores its intractability by its repudiation of the law governing compensation as stated by this Board. PYCO and WTL reiterate that they should not be subjected to SAW's unreasonable demands long after alternative service has ended. SAW's unreasonable claims should be barred by laches, by its failure to negotiate compensation in good faith, and by its failure to present a casea responsive to this Board's January 11 decision.

IV. Conclusion

SAW's filings are stubbornly unresponsive to Dardanelle and this Board's January 11 decision. A fortiori, SAW should be deemed to have waived any right to compensation. In any event, compensation should be no greater than the amount stated by WTL and PYCO, subject to set-off's. The statements of SAW's witness, Mr. Olmstead, should be stricken or given no weight, as unreliable. SAW's demands for a windfall should be rejected or ignored.

Respectfully submitted,

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Railway Co.

Attachments: Verification of Robert Lacy
Exhibit-Second Declaration
of Charles Banks (RL Banks & Associates)

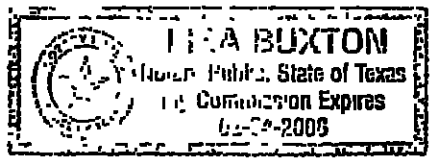
Verification by Robert Lacy

I, Robert Lacy, am the Senior Vice President, Marketing, for PYCO Industries, Inc., I bear overall responsibility for rail transportation matters for PYCO, I have read the foregoing Reply Memorandum, and the facts stated therein are true and correct to the best of my information, knowledge and belief.

Robert Lacy

Sworn to and subscribed before me this 22nd day of February, 2008.

Lisa Buxton
Notary public



My commission expires: 2-24-08.

Exhibit

Second Declaration of Mr. Banks

BEFORE THE SURFACE TRANSPORTATION BOARD

South Plains Switching Ltd. –)

Compensation for Use of)

Facilities in Alternative) F.D 35111

Rail Service – West Texas &)

Lubbock Railway Co.)

Second Verified Statement of

Charles Banks

I, Charles H. Banks, am a railroad economist at and President of, R.L. Banks & Associates, Inc. (RLBA), a nation-wide consulting firm focused entirely on railroad economics, operations and engineering issues. RLBA and I personally have been engaged more than fifty times in the last twenty years on rail property valuation projects by both private and public sector clients interested in acquiring rail lines or segments. In my previous job, I was part of a small team of economists at the United States Railway Association which defended the interests of the Federal Government in the largest railroad valuation case in U. S. history (the Penn Central Valuation Case). Therefore, I am more than familiar with the methodologies used by rail economists and by real estate appraisers to develop such valuations. Moreover, my firm and I are generally familiar with the former South Plains Switching Ltd. (SAW) properties, inasmuch as other RLBA staff and I have supplied statements on behalf of PYCO Industries in the feeder line proceeding (Finance Docket 34890) involving those properties in Lubbock, portions of which trackage are at issue here.

1. In this proceeding, to determine compensation to SAW for use by West Texas & Lubbock Railway (WTL) of portions of formerly SAW property to provide alternative service to PYCO, SAW relies upon opinions advanced by Mr. Dennis Olmstead. PYCO has requested that I review the methodology employed by Witness Olmstead in his statements filed in this proceeding to determine if they meet the standards employed in the discipline of economics and as customarily used by real estate appraisers as regards valuing rail property in a situation like the one at issue here. I conclude they do not.

2. Mr. Olmstead evidently purports to offer opinions on "fair market value," a concept in economics, often applied to the appraisal of real property. Nowhere does Witness Olmstead attach a resume showing any basis on which he is qualified to offer a reliable expert opinion with respect to either an economic- or real estate-based valuation. Instead, on the first page of his "Verified Statement" filed on February 11, 2008 and elsewhere, he represents only that he is "in the consulting business." In his statement, as in his resume (entitled "Background and Statement of Qualifications") attached to his statement on behalf of SAW (tab 4, Appendix) in SAW's Statement in Response to PYCO's Feeder Line Application to Acquire "All-SAW," filed in Finance Docket 34890 on Sept. 18, 2006, Mr. Olmstead claims no formal training in economics or real estate appraising, representing only that he was the "marketing and executive department" representative of a "line sale team" at BNSF during his last six years there, terminating in 1996. He states his function was writing line sale proposals (this does not in general involve valuations, only the solicitation of same) and he evidently participated in a team evaluation of responses. While such efforts may well have involved valuation, it also may simply have been as easy as determining the highest bidder and, in any event, does not indicate that BNSF relied upon him in connection with the provision of any independent economics or appraisal expertise.

3. Mr. Olmstead's approach to determining value does not comport with the various methodologies taught in the discipline of economics, nor with the methodologies followed by real estate appraisers. Witness Olmstead asserts that the "best way to determine fair market value ... is to determine whether there is any contemporary charge that is being assessed and paid for [comparable] facilities in the same general territory." For many reasons, this is neither a valid nor acceptable test of "fair market value" ("F.V.").

4. Witness Olmstead begins his testimony by suggesting an analogy: he states that the way to determine the "market value" of coffee in Montrose, Colorado is to determine a price range between a local coffee shop and Starbucks. But the analogy is not appropriate. The issue is not what at what prices a local coffee shop and Starbucks sell their products (which they may well view as different from each other in any event) but the fair market value of using a particular property (in the case posed by Witness Olmstead, the land and building occupied by the local coffee shop or Starbucks).

5. Fair market value is generally understood to mean a value based on a willing buyer and willing seller, both knowledgeable, with neither party under a compulsion to sell or to buy. A principled appraiser disregards all sales under compulsion and instead searches for all comparable sales or rentals in the appropriate market area. In contrast, Witness Olmstead has done neither and violates that approach in two fundamental ways First, the BNSF/SAW agreement reflected a litigation settlement which, if under compulsion, as it appears to be, would not be appropriate to consider as indicative of a "market" value at all. Second, he focuses solely on a single transaction involving BNSF and SAW (the $75/carload agreement at Burris); hardly a statistically valid sample size. Furthermore, there were other reasonably contemporary rental agreements (e.g., SAW leased track 9298, directly involved in alternative service to PYCO, for $1/year) which Mr. Olmstead inexplicably disregards. So, Witness Olmstead appears to rest his opinion of value on the highest "price" in the Lubbock area, without considering that the price he relies upon was apparently reached under compulsion and without examining any other prices.

Those violations are contrary to established and accepted methodological practice employed by qualified appraisers.

6. As to economics, one must draw some careful distinctions. If an economist is asked to determine a "market value," he should inquire into revenue streams and costs, imputing a positive value to a business as a going concern if discounted revenues exceed discounted costs He or she also should inquire into break up value, that is, the value of the business in liquidation. Indeed, this Board followed that approach in the feeder line proceeding, in which this Board has already determined that the overall "going concern value" of all of SAW (including the Burris trackage) is less than the "net liquidation value" of all of SAW (including the Burris trackage). Mr. Olmstead's reliance on a particular revenue stream ($75/carload from Burris) as indicative pricing for the balance of SAW either as a going concern or in liquidation is obviously both theoretically flawed and contrary to established economic valuation principles. Although SAW sought to include the Burris revenue stream in the going concern value of the "all-SAW" scenario in the feeder line proceeding, I did not understand it to claim that this value governed the rest of its business and although this Board included the Burris stream in calculating going concern value, it properly did not impute that stream to the rest of SAW's business. To have done so would not comport with economic principles.

7. In addition, there is a distinction between "fair market price" and "market price" as that term is used by Witness Olmstead. If the Burris price is the result of a local monopoly power enjoyed by SAW (due to a lawsuit), then it may be expected to reflect a monopoly profit. But as Witness Olmstead stated, the task is to determine a "fair market value." Assuming the Board has determined that the net liquidation of a rail line or segment is higher than the going concern value of same, as it has determined in this proceeding, this Board generally achieves that objective by determining the net liquidation value of a rail property and then (for rental-type situations): a) applying a railroad cost of capital (generally based on the Board's annual determinations) and b) adding appropriate variable costs expenses incurred by the incumbent railroad. Yet, Witness Olmstead ignores the Board's established methodology entirely.

8. For all these reasons, Mr. Olmstead's methodology does not comport with either the discipline of economics nor accepted methodologies employed by real estate appraisers. Even if Witness Olmstead were qualified to offer an opinion, which he is not, his opinion accordingly, would be unreliable.

9. Witness Olmstead also advances a new theory that SAW did not rely upon in the feeder line proceeding involving storage of cars. Witness Olmstead contends that WTL enjoyed exclusive use of 14,180 feet of trackage, which could hold 236 cars and posits (for no apparent reason) three weeks storage per car before its instantaneous replacement. He then claims that SAW is entitled to $100 in switching fees per hypothetical stored car plus $1.25 per day in storage fees, resulting in huge, lost revenues of $923,940. This approach obviously does not comport with appraisal methodology or with sensible economic analysis. To list just a few reasons the numbers calculated are bogus under either approach:

- Witness Olmstead's analysis does not consider costs and is thus more than a "lost profits" claim; it is a claim for lost revenues ignoring associated costs;

– in any event, there is no showing by Mr. Olmstead or by SAW that SAW lost either revenues or profits associated with storage of cars. in particular, based on inspections by my firm, SAW had ample additional track on which to store cars in Lubbock; no SAW witness has shown that SAW had to turn away any cars tendered to it for storage; nor has any SAW witness made any showing that WTL used the trackage other than to supply obligated, common carrier services to PYCO);

- no SAW witness has shown or attempted to show that SAW (or PYCO) actually charged or collected the amounts set forth by Witness Olmstead and WTL did not charge for or receive any such revenue from PYCO;

- if SAW were to store cars on the trackage as it suggested, then rail cars could not be delivered to PYCO Plant Number 2. (PYCO has furnished evidence that the alternative route was congested by SAW.) Since the trackage was needed to fulfill common carrier obligations to PYCO, it could not be used for storage as suggested by Witness Olmstead anyway: it is not "comparable." "Fair market value" is not the highest value that can be imagined by ignoring reality, including among other things lack of demand (e.g., for storage), alternative supply options (e.g., other trackage available), all costs and whether imagined revenue streams were or could be collected.

10. It is my expert opinion that Witness Olmstead lacks the credentials (either by special education or demonstrated experience) to offer an expert opinion on the value of the property at issue here and that he did not employ any of the established methodologies and tests used by economists or real estate appraisers. His opinion is accordingly unreliable and not worthy of any weight.

Pursuant to 28 U.S.C. 1746, I declare and verify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Charles H. Banks

Executed on: February 21, 2008.